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INDUSTRIAL DEVELOPMENT AND COOPERATION ACTIVITIES: INDUSTRIAL DEVELOPMENT COOPERATION

The external debt and industrial development

Report by the Director-General

Summary

Provides additional, updated information on the effects of the external debt on the developing world and on UNIDO efforts to attenuate problems related to the external debt.

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Introduction

1. In compliance with General Conference resolution GC.5/Res.9 on the external debt and industrial development, a report on the subject (GC.6/6-IDB.13/13) was submitted to the Conference through the Industrial Development Board at its thirteenth session. The present document updates some of the information provided in that report.

I. RECENT DEVELOPMENTS IN THE EXTERNAL DEBT CRISIS

2. As pointed out in the previous overview (GC.6/6, para. 2), compared to the situation in the 1980s, the debt crisis currently exerts less pressure on the international financial system. A combination of domestic reform programmes and commercial debt relief and restructuring under the Brady plan has improved the situation of many countries, in particular Latin American and other middle-income debtor countries.

3. According to the *World Debt Tables 1994-95*, the external debt of all developing countries grew to $1,812 billion at the end of 1993 — a 7 per cent increase in nominal terms from the previous year's level — and is projected to reach $1,945 billion by the end of 1994. The increase in debt stock in 1993 resulted in a slight growth in the debt-to-exports ratio to 172 per cent for developing countries overall, but the divergence across regions is significant. It ranges from 552 per cent for the severely indebted low-income countries to 72 per cent for other countries. In the same period, the debt-servicing-to-exports ratio rose to 18 per cent, reversing the downward trend of the past few years but reflecting the clearance of arrears. That trend is expected to pick up again in 1994, with a further decline to 17 per cent for developing countries and with declines recorded in all regions and income groups except the severely indebted low-income countries.

4. Whereas overall net long-term resource flows to developing countries have been increasing in both nominal and real terms since the mid-1980s, the 1990s have witnessed particular growth of private capital flows. Between 1990 and 1993 the total aggregate net long-term resource flows rose from $103.4 billion to $213.2 billion and they are projected to grow to $227.4 billion by the end of 1994. This surge in resource flows resulted mainly from a phenomenal growth of portfolio equity investment, continued strong growth in foreign direct investment (FDI), and a burst of bond issuance. As a result, the share of private capital flows in total net resource flows to developing countries has been growing steadily, accounting for about three-fourths of the total net aggregate in 1993 (up from 44 per cent in 1990). Official development finance (comprising grants and bilateral and multilateral loans, both concessional and non-concessional) accounted for the remaining one-fourth. About 55 per cent of these flows were directed to low-income countries, for which official sources represent about 40 per cent of all external inflows.

5. The bulk of private resource flows has been directed to a small number of countries, most of which are middle-income countries in East Asia and Latin America. There are only two important exceptions among the low-income countries: China and India. In absolute terms, China was the major recipient of external financing among developing countries in 1993. Not only has the magnitude of private capital flows to developing countries in the 1990s been considerably larger than in the 1970s, but the range of financial instruments has also been wider. In the 1990s there has been a sharp rise in net resource flows to the private sector in recipient countries. Aggregate private-to-private flows accounted for about 70 per cent of the net long-term flows to developing countries in 1993.

6. Although the debt crisis currently does not seem to disrupt the international financial system, many low-income countries are still struggling with large debt overhangs and are heavily dependent on official development assistance (ODA) for external financing. The debt of the severely indebted low-income countries, most of them in sub-Saharan Africa, is small in absolute terms, but alarmingly large in relation to their exports and gross national product (GNP), revealing the fundamental incapacity of those countries to service their debt. Their crisis is not just a problem of short-term liquidity but a problem of long-term insolvency caused by the limited productive base, coupled with severe foreign exchange shortages. It is the lack of dynamic competitive industrial structures that constitutes the key underlying problem.

7. The primary objective of official creditors, the main and almost unique source of financial resources for these countries, has been to provide a constant flow of new concessional financing to ensure that their efforts to develop would not be frustrated by lack of access to external financial funds. A special initiative of the Paris Club (the "Naples terms") designed to facilitate debt stock reductions does not go far enough to provide the desired exits from the rescheduling process. This strategy has certainly kept the severely indebted low-income countries above water, but there is still a need for greater debt relief on a case-by-case basis. However, it has to be borne in mind that, while reductions in outstanding claims would release resources and improve the investment climate, it is domestic policy that in the end holds the key to the future prospects of those countries.

II. RELEVANT UNIDO ACTIVITIES

8. The building up of a sound industrial base significantly contributes to the establishment of a sustainable relationship between external borrowing and future income. UNIDO technical cooperation activities aim at building up a viable industrial supply capacity that can lead to sustainable development and can thus be regarded as a means to attenuate the negative effects of external debt on industrial growth. With a solid industrial base, developing countries are able to capture emerging opportunities in global markets and thereby earn a regular flow of export earnings, part of which may be used to service the external debt.

9. Fully aware of the gravity of the debt crisis in the severely indebted low-income countries, UNIDO is continuously and substantially assisting such countries in establishing competitive production structures in various industrial sectors. The Organization has also recognized that the identification of innovative approaches to industrial financing is fundamental in the attempt to attenuate the negative effects of external debt on industrial development in those countries. In that context, UNIDO is elaborating a suitable debt-for-industry swap scheme to be implemented, especially in sub-Saharan Africa.

10. Details of UNIDO activities of relevance to the external debt of developing countries were provided in chapter II of document GC.6/6.

III. ACTION REQUIRED OF THE CONFERENCE

11. The Conference may wish to take note of the report contained in document GC.6/6 and the additional information provided above.